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William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW Room 222
Washington, DC 20554

Dear Mr. Caton:

Enclosed are the original and four copies of the comments of GVNW Inc./Management in response to the Commission's Public Notice in CC Docket 96-45 (Reference DA No. 96-1891) released November 8, 1996.

Also enclosed is one copy of our comments to be stamped and returned in the enclosed self addressed stamped envelope.

Any questions regarding this filing may be directed to me at (503) 624-7075.

Sincerely,

Kenneth T. Burchett

Kenneth T. Burchett
Vice President

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

COMMENTS OF GVNW INC./MANAGEMENT

Summary

GVNW Inc./Management (GVNW) is a management consulting firm which provides financial and regulatory consulting services to independent telephone companies. These comments focus primarily on the impact the Joint Board Recommendations may have on small rural LECs and, ultimately, on the provision of quality universal service at affordable prices throughout rural America.

The Joint Board Recommendations (Recommendations), if adopted, will necessitate substantial changes in the revenue streams of independent telephone companies. These companies have relied on the continuation of these historical revenue streams in designing and installing state of the art technology in sparsely populated areas where it would otherwise be uneconomical to invest. Unfortunately, the Recommendations fail the three pronged test specified in the Act. The Act specifies that revenues necessary for the provision of universal service must be "sufficient, predictable

and specific."[1] If the Recommendations are adopted without significant modification, it is likely that telecommunications services in many rural areas will be more costly for a lower grade of service than is available in urban areas. Uncertainty in current and future revenue streams will result in reduced investment and will certainly have a negative impact on the quality of telecommunications services available within the United States for years to come.

The proxy methodology endorsed in the Recommendations will not provide proper incentives to Eligible Carriers to provide quality service in high cost service territories. Instead, the financial incentive for a carrier serving a high cost area where little or no facilities based competition exists will be to invest just enough to maintain minimum standards of service thereby assuring continued revenues from the Universal Service Fund. Competitive incentives to invest will only occur if viable, facilities based competition also exists. It is unlikely that such competition will exist in high cost rural areas for years to come. Universal Service Support payments in high cost areas without viable facilities based competition should continue to be based, not on some theoretical estimate of costs which may never be invested, but on real investments made to provide quality telecommunications services. Support based on actual cost should be available in all instances where state commissions have only authorized one Eligible Carrier in a specific geographic area. If a state commission authorizes more than one Eligible Carrier, carriers can be required to phase in a proxy model as was recommended in the decision. The basis

[1] Telecommunications Act of 1996, Section 254 (b) (5).

for this position will be discussed in greater detail as specific Joint Board Recommendations are analyzed.

Competitive Neutrality

The law is clear that Competitive Neutrality is a principle which should govern eligibility for Universal Service Support. We are in agreement with this concept. However, Competitive Neutrality is only one of several important principles which must be satisfied. Its accomplishment will be worthless if the telecommunications users do not benefit with the continued availability of quality telephone service at affordable prices.

Competitive Neutrality can be accomplished without the use of proxies. It will be accomplished provided that procedures are established that ensure that all Eligible Carriers in a given geographic area are eligible for support based on the same procedures resulting in support levels for each Eligible Carrier. Despite the tentative conclusion of the Joint Board, GVNW continues to support the development of support levels based on actual costs incurred by the incumbent service provider provided the incumbent is the only Eligible Carrier authorized. This type of methodology would maintain Competitive Neutrality while ensuring that at least one Eligible Carrier has a financial incentive to continue investing in infrastructure resulting from the continuation of sufficient and predictable revenue streams tied to actual investment.

The universal service system must recognize that without predictable cost recovery and profit potential, the results could work against universal service and competition as prudent management will not build facilities, lenders will withhold loans due to inadequate security, and stockholders will pressure against costly expansion.

Commenters have expressed concern that the use of actual cost encourages gold plating. There is no significant evidence of gold plating and to the contrary, overwhelming evidence of rural telephone companies prudently bringing quality services to their customers at reasonable rates.

Definition of Universal Service

The Recommendation states that equal access should not be included in the definition of universal service at this time "because of the potential costs to wireless carriers involved in upgrading facilities and because wireless carriers are not currently required to provide equal access."[2] The logic employed by the Joint Board fails the principle of Competitive Neutrality contained in The Act and endorsed by the Joint Board The Recommendation also ignores the fact that equal access has been deployed by carriers, has been subscribed to by residential customers, and is consistent with the public interest; representing three of the four criteria established in the Act.[3] Equal access is a cornerstone of level competition in the toll arena just as number portability will be with local competition. Incumbent LECs have already incurred the cost of upgrading their networks to offer equal access. Most end user customers have this service and expect to receive it from any local service provider. It is illogical to downgrade the services which should be expected by the American public because a future competitor that wishes to receive funding from the Universal Service Support Fund would be forced to invest in its network. Using this backwards logic would suggest that incumbent LECs, that have

[2] CC Docket No. 96-45 Released November 8, 1996 at Paragraph 66.
[3] Telecommunications Act of 1996, Section 254 (c) (1).

previously made the necessary investments to provide equal access should be afforded the opportunity to discontinue the provision of equal access, an option which all would agree would not be in the public interest or competitively neutral. The principle of Competitive Neutrality demands that all Eligible Carriers be subject to the same standards of performance and service quality. Equal access should be included in the definition of universal service and, a timeline should be established at which time it is required in order to qualify for support.

Requirement to revisit the Definition of Universal Service

The Act defines Universal Service as "an evolving level of telecommunications services that the Commission shall establish periodically..."[4] We support the regular revisitation of the definition by the Commission as proposed in the Recommendation. However, in recognizing that the definition will change in the future, the Recommendation does not provide any financial incentives for an Eligible Carrier in a high cost area to provide any services beyond the bare minimum required based on the Universal Service definition then in effect. The provision of new and enhanced services in rural and high cost areas will not occur unless there is a reasonable expectation of cost recovery and a reasonable profit. If a subsidy is necessary to make a new service economically feasible, Eligible carriers will be unable to deploy the new services due to a lack of sufficient revenue streams. At the time the definition of Universal Service is modified, Eligible Carriers that have not invested (because anticipated revenues would not be "sufficient") will no longer qualify to receive Universal Support Funds since they will be unable to provide all of the defined services.

[4] Telecommunications Act of 1996, Section 254 (c) (1).

In high cost areas, a successful transition to an "evolving definition of Universal Service" will necessitate that funding recognize that supported services will continue to evolve as technology improves and customers demand new services.

Limit Support to One Residential Connection at a Principle Residence

The Joint Board recommends that support be limited to (1) a single connection at a subscriber's principal residence, (2) a reduced amount for a single connection at a business, and (3) no support whatsoever for multiline businesses or vacation homes. Once again, the Recommended Decision chooses a theoretical approach rather than one which can actually work effectively to achieve the universal service principles identified in the Act. This Recommendation raises numerous questions regarding how such restrictions could ever be enforced. For example:

- How will the determination be made when a home is utilized as a secondary or primary residence? It is likely that second homes will not be in the same exchange area or even in the serving area of the same LEC.

- How will the Eligible carrier be identified if a customer obtains two lines, each from a different Eligible Carrier?

- How will multiple line services be restricted? The Recommendation suggests that this can be accomplished by examining billing addresses. Such an undertaking will be costly and ineffective.

- Who will establish the definition of "business" and "residence?" Competition will push retail rates closer together. Value of service pricing as is presently utilized will gradually disappear.

What sort of incentives will such restrictions give Eligible Carriers to invest in the infrastructure necessary to provide sufficient cable plant in rural and high cost areas? If revenue streams are designed so customers can only afford to purchase one line per household in a high cost area, carrier's network designs will incorporate only that which can be economically justified. When customers request second lines, facilities will not be available. For example, if, at some time in the future, the definition of Universal Service is modified to include Internet Access over separate facilities, Eligible Carriers will not have facilities available to provide the service.

Qualification for Universal Service Support should encourage Eligible Carriers to invest for the future. The restrictions contained in the Recommendation will force Carriers to invest only for the present since there will be no financial incentives in high cost areas to offer anything but the bare minimum of service quality. At a minimum, costs associated with multiple lines should be incrementally identified while fully attributing joint and common costs associated with multiple lines to the first line.

Support should be extended to multiline businesses and support for single line business lines should be at the full amount. There is no valid justification for not encouraging universal service regardless of whether the customer is an individual or a business. Failure to provide support to the relatively few multiline business customers located in rural areas will only result in fewer revenues from customers and greater reliance of Eligible Carriers on the Universal Support Fund. Rural areas which already face a fragile economic future will be further harmed by the Recommendation regarding reduced support for business subscribers.

The exclusion of second homes from qualification introduces further enforcement problems. Policing such restrictions will be costly if not impossible. Who will decide when a home is a "second" home? What criteria will be utilized to convert a vacation home to a primary residence? The rules, when adopted, must avoid the substantial problems which will be caused by such restrictive enforcement of qualifying residences.

Determination of Eligible Carriers

We support the Recommended Decision restricting eligibility to those carriers that utilize their own facilities in total or in combination with another carriers facilities. Carriers providing service based strictly on resale should not be eligible for Universal Service funding. The Recommendation is not clear regarding whether this requirement is on a "per service area basis," or a "per connection basis." The restriction should be clarified so that the determination is made on a per connection basis, not a service area basis. Carriers reselling a retail service should not be Eligible for Support. Qualification should only occur when a specific customer's service is provided by an Eligible Carrier's own facilities or a combination of an Eligible Carrier's own facilities and resold network elements obtained from another carrier. This clarification will eliminate the possibility of an Eligible Carrier providing a retail service (which has incorporated universal service funding in its retail price) at a wholesale rate to a competitor that then becomes eligible for universal service funding.

Service Areas Served by Rural Telephone Companies

GVNW supports the Recommendation that the Commission retain the current study areas of rural telephone companies as the service areas thereby requiring competitors to serve the entire study area in order to be an eligible carrier in areas served by small rural telephone companies. This is a positive step in ensuring that "cream skimming" is minimized in rural areas. This action will not eliminate the cream skimming which may occur in rural areas where the new competitive carrier chooses to serve a smaller area than the incumbent's study area and not qualify as an Eligible Carrier. This possibility reinforces the need to provide "sufficient" support to Eligible Carriers serving high cost rural areas so an Eligible Carrier is not forced to internally subsidize the service provided to its most rural customers.

Calculation of Universal Service Fund Support

The use of the proxy models, as is presently being considered, will not encourage investment in the infrastructure necessary to provide telecommunications services in rural, high cost areas. This fundamental problem with the Joint Board Recommendation endangers the availability of quality telecommunications service in rural America. We disagree with those commenters who assert that the use of embedded costs will not promote competitive neutrality.[5] Competitive neutrality is achieved as long as all Eligible Carriers can receive support for meeting the obligations of an Eligible Carrier. Utilizing the embedded costs of an incumbent LEC is a perfectly logical and acceptable alternative to the use of theoretical proxy models when the incumbent LEC is the only authorized Eligible Carrier. By requiring the incumbent LEC to transition to proxies following the authorization of an additional Eligible Carrier, competitive neutrality is maintained. If no other carriers are willing to meet the obligations of an Eligible Carrier based on the funding available, then it is apparent that the universal service goals have been achieved in an economically efficient manner.

[5] CC Docket No. 96-45 Released November 8, 1996 at Paragraph 212.

Such a methodology based on embedded costs will minimize the undesirable effect that proxy models will create of allowing windfall profits for those companies who face little or no competition and whose actual cost of service is below the amount estimated by the proxies. It also minimizes the potential problem of not providing sufficient revenues for those companies whose costs are greater than that estimated by the proxies.

The Telecommunications Act is designed to encourage competition. If quality services are available at affordable charges from one Eligible Carrier, and other carriers still do not choose to enter the market even though they are eligible for universal service fund support, then the universal service goals identified in the Act have been satisfied. It should not be the goal or result of the Universal Service Fund to subsidize uneconomic market entry.

Proxy costs will not result in Predictable and Sufficient Revenue Streams

The Recommended Decision states that "it is vital that the Commission use forward-looking economic costs as the basis for determining support levels. If support is based on embedded costs for the long-run, then incumbents and new entrants alike will receive incorrect signals about where they should invest."[6] We disagree with this conclusion. In order for this conclusion to be correct, it must be assumed that the proxy utilized is an unchanging, perfect predictor of future costs. This is simply not possible. Even a perfect forward-looking proxy (if such a thing exists), becomes outdated almost as soon as it is released as technology changes and the definition of universal service is reexamined. Regardless of whether proxies or actual embedded costs are utilized, the cost

[6] CC Docket No. 96-45 Released November 8, 1996 at Paragraph 275.

figure utilized will be a constantly evolving and changing target. The conclusion that support based on embedded costs could jeopardize the provision of universal service is false.

All profit oriented companies, regardless of industry, must have the opportunity to establish rates which are sufficient to recover actual costs incurred and still achieve a profit. In a competitive market, investments will only be made if there can be a reasonable assumption that the stockholders will earn a positive return. If the customer chooses not to buy at the price established by the company, the company will find it necessary to adjust rates or reduce costs. If it is unsuccessful in adjusting rates in a way which will allow recovery of actual costs, the business may fail. In a competitive market, only those companies successful in establishing prices which recover historic embedded cost will be successful.

The Recommended Decision does not address how often proxies will be recalculated or how to appropriately define "least cost forward looking". The definition of forward looking should allow companies to invest in facilities which can provide services which will be required in the future. It is likely that technology will continue to evolve resulting in a continued reduction of the forward looking cost of providing services. Under this scenario, even for an Eligible Carrier receiving sufficient funds at the time of investment to justify their expenditure, a forward looking study completed in the future can easily result in lower Universal Service Support than was anticipated at the time the investment was made. The Recommendation should be modified so that Eligible Carriers can rely on the receipt of Support Funds for the economic life of the plant necessary to provide Universal Service without concern that universal service support may vary widely from year to year. Unless this modification is made, Eligible Carriers will not be able to rely on continued support and the fund will not be sufficiently "predictable" to justify major investments in infrastructure.

The fallacy of using any Proxy model to determine funding levels is the failure to require the Eligible Carrier to actually utilize those funds in the provision of quality services. This fallacy may well be in violation of the Act which states that, "A carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."[7] The carrot and the stick is a time tested, well proven incentive mechanism missing from the Joint Board Recommendations.

Specific Proxy Model Concerns

GVNW has attempted to analyze all proxy models presently being considered regarding their applicability to small, rural LECs. Our analysis has convinced us that none of the models accurately predict the costs which are actually incurred in providing service in those areas served by small rural companies. Specific concerns with each model are identified and discussed in Appendix B. The biggest problem with proxies is the census block approach which does not consider existing wire centers or study areas. A wire center or study area approach for rural companies allows for a substantial improvement in accuracy, consistency and predictability. Administering a support fund at a census block group (CBG) level or Grid level would be too burdensome and costly. As stated

[7] Telecommunications Act of 1996, Section 254 (e).

previously, we support the Joint Board's recommendation that rural LEC study areas be utilized. All proxy models must be revised to reflect this recommendation.

Rural Carrier Proxy Phase In

The Joint Board recognized that a great deal of work is necessary before any Proxy models can accurately predict the costs rural telephone companies will incur in providing universal telephone service.[8] They conclude that, because of this difficulty, rural carriers should have the option of phasing in the use of Proxies to avoid, "large changes in the support that they receive."[9]

Although we disagree with the Recommendation that proxies be utilized, we support the Joint Board's recommendation that the use of proxies (if ordered) be phased in for rural carriers. As previously stated, we believe actual costs should be utilized by Eligible Carriers until such time as another Eligible Carrier is authorized. At that time, the phase in to proxies could begin. The phase in should be based on actual cost incurred during the phase in period rather than establishment of a frozen amount per loop based on historical costs as has been proposed. Establishing a frozen amount is particularly onerous for small companies which find it necessary to undertake substantial plant upgrade projects every few years rather than a continuous, level reinvestment plan. The Recommendation provides no incentives for future investments given the uncertainty regarding the amount of future USF support available. Utilizing a phase in based on actual cost incurred during the phase in period would be consistent with earlier decisions of the Commission

[8] CC Docket No. 96-45 Released November 8, 1996 at Paragraph 283.
[9] CC Docket No. 96-45 Released November 8, 1996 at Paragraph 283.

regarding the initial eight year phase in of the current USF as well as the DEM weighting phase in.

In the event our recommendations regarding a phase in based on actual cost incurred during the phase in period is not granted, we recommend further modifications to the Joint Board Recommendation regarding the phase in period. We do not agree with the time periods recommended for determining the frozen per line amounts. The use of past periods[10] will not result in a reasonable calculation of frozen costs suitable for use during the phase in period. Those carriers which have aggressively updated their outside plant facilities in 1996, many in compliance with state commission directives, have no opportunity to include those substantial embedded costs in their frozen per loop amounts. Under the existing universal service fund rules, loop investments made in 1996 would be reflected in universal service fund payments received in 1998. These investments were made in 1996 based on the reasonable assurance that costs could be recovered based on existing cost recovery mechanisms. Establishing 1998 forward looking revenue streams based on historical costs which occurred in 1995 without consideration to costs incurred in 1996 is unfair to incumbent carriers and violates the terms of the Act which requires that support must be "sufficient and predictable."

The period when costs are frozen should be the most current available and should not be for a period when the carriers have no ability to modify their investment policies to reflect the reality of future revenue streams. For those companies which made large loop

[10] CC Docket No. 96-45 Released November 8, 1996 requires that Federal USF frozen amounts be based on 1995 activity and frozen amounts for DEM weighting be based on 1996 activity.

investments in 1996, they may have no choice under the Recommended Decision but to convert to proxies immediately. This is certainly not a "predictable" revenue stream as required by the Telecommunications Act of 1996. The Recommendation should be modified to allow the frozen per loop amount for USF to be based on 1996 actual costs rather than 1995 actual costs as is the Long Term Support and the DEM weighting frozen amounts. This modification can be made with a minimum of effort as the historical USF calculations have been accomplished for several years by NECA and incumbent LECs. The existing cap on growth in the USF fund will assure that total increases in the amount of the fund remain reasonable. Without this modification, those companies that made substantial investments in 1996 on the assumption that the universal service fund mechanism would assist in future cost recovery will find that there are no future revenue streams available to assist in recovering these costs. Appendix A provides a hypothetical example of the negative financial impact which the Recommendation will have on a rural company if the Recommendation is not modified as we have requested.

In addition to the problems associated with the time period when costs are frozen, the Recommended Decision also inappropriately recommends that Support Funds be based on historical loop counts multiplied by the frozen per loop amounts. Specifically, 1998 revenues will be determined by multiplying the frozen amount per loop times year end 1996 loop counts. Although the Recommended Decision states that, "Rural carriers would receive additional support at the same amount per line as the number of subscribers increase,"[11] utilization of two year old loop counts will not result in sufficient increases in

[11] CC Docket No. 96-45 Released November 8, 1996 at Paragraph 290.

revenue to reflect access line growth. In fact, the amount of revenue can actually decline from 1997 to 1998 as a result of utilizing outdated line counts. 1998 revenues should be determined by utilizing year end 1997 loop counts rather than year end 1996. We recommend that this change be included in the rules.

Rural Carrier Proxy Phase In for Acquiring Companies

During the past few years, numerous acquisitions have taken place where small, rural LECs have purchased assets from large LECs. Based on Commission authorization granting necessary study area waivers, these companies have anticipated up to a two year lag in receipt of federal universal service funds. With the implementation of the proxy phase in, those companies acquiring property in 1995 or 1996 will be unable to develop a realistic frozen amount per line since USF payments have not been allowed to reach their fully phased in amount. Procedures should be established to allow these companies to establish a frozen amount per loop for the existing USF fund which reflects a full years worth of actual activity as well as infrastructure upgrades required by state commissions in order to provide adequate universal service. Without this special treatment, these carriers may be forced to immediately convert to a proxy based settlement system which may not be sufficient for rural LECs.

Determination of a Nationwide Benchmark

The Joint Board recommends the development of a nationwide average of revenues per line. The difference between the nationwide Benchmark and the individual carrier proxy calculation for a given area will determine the amount of Support paid. Separate Benchmarks are recommended for single line business and residence. Use of this

Benchmark will not encourage investments necessary to serve customers located in high cost areas where the actual cost of providing service is greater than the hypothetical cost identified by the proxy.

If the FCC adopts the Joint Board's recommendation of developing a nationwide Benchmark, we recommend that the Commission exclude the access revenues that will not be received in a forward looking environment as a result of the interconnection order, proceedings currently under consideration (such as removal of LTS from non pool members CCL rates), and the anticipated access reform proceeding. Without this adjustment, LECs will be unable to realize the nationwide average revenue anticipated in the Benchmark.

Appropriate Use of Proxy Models

As stated, GVNW does not favor the use of proxy models in determining actual payments to Eligible Carriers due to the improper investment signals such payments will cause. It is apparent, however, that there is little possibility that the final decision in this Docket will completely disavow the Joint Board Recommendation regarding proxy use. In an effort to minimize the negative impact on universal service which will be caused by the false economic signals inherent in a proxy methodology, GVNW recommends that, at a minimum, small rural carriers universal service support be based on embedded costs as previously described, until such time as the state commission determines that facilities based competition from another Eligible Carrier actually exists within the study area of the incumbent. Following such a determination by the state commission, the incumbent Eligible Carrier could be required to begin a phase in to proxies.

Funding High Cost Support

Despite substantial efforts to quantify the cost of the new fund, the final price tag has not been determined. It is estimated that the cost of implementing the proxy model will range from $5 billion to $14 billion.[12] This huge cost will necessitate that carriers who are required to contribute be prohibited from implementing substantial flat rate end user surcharges as a means of recovering their cost. As stated by Commissioner Chong, "Let us make no mistake about who will foot the bill for this universal service program. It is not the telecommunications carriers, but the users of telecommunications services to whom these costs will be passed through in a competitive marketplace."[13] Long Distance carriers, in response to competitive pressures, may attempt to pass the costs through to end users on a flat rate basis in order to keep usage charges low. This would be advantageous to long distance carriers attempting to remain competitive in the usage sensitive toll market at the expense of low volume residential toll users. If appropriate safeguards are not implemented restricting the amount of flat rate end user charges which can be charged, the cost of funding universal service may result in unaffordable flat rate pricing to residential customers. Maximum end user flat rate charges by long distance carriers should be established. For recovery of costs beyond the universal service funding requirements recovered via flat rate end user charges, long distance carriers should be free to surcharge usage based toll services.

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[12] Separate Statement of Commissioner Julia Johnson and Chairman Sharon L. Nelson.
[13] Separate Statement of Rachelle B. Chong.

The Recommendation that contributions be based on a carrier's gross telecommunications revenues net of payments to other carriers unfairly places an excessive funding requirement on LECs to the advantage of long distance carriers. In order to avoid disparate treatment of LECs and long distance companies, and to spread funding over the broadest base of telecommunications services possible, LECs will find it necessary to charge access customers as well as local service customers. As long as LECs have universal service obligations, regulators have an obligation to allow the opportunity to recover reasonable costs of doing business. The funding of the universal service fund is certainly a reasonable cost of doing business and should be treated as such. Extreme care must be taken by the Commission to formulate policies which will result in the cost of funding being spread across a broad base of telecommunications services and not weighted unfairly to the local service user.

If a determination is made that the interstate universal service fund is funded in part based on intrastate revenues, it must be done so on a competitively neutral basis so that carriers pay an equal amount regardless of whether they are authorized for only interstate or only intrastate service. If such a decision is made, consistency demands that any state universal service funds also be allowed to fund the state responsibility based on interstate revenues as well as intrastate revenues.

Concerns with State Jurisdiction Issues

The effort to explicitly identify all implicit subsidies in response to the Act (both interstate and intrastate) will have as yet unidentified financial consequences in the intrastate jurisdictions. These consequences will manifest themselves most dramatically in rural states with small populations where funding will be more difficult to recover without significant end user rate impacts. It appears that the Joint Board Recommendation assumes that as long as the federal universal service fund replaces existing interstate universal service funds and all existing interstate implicit subsidies, states should be responsible for any additional explicit funding which is necessary to accomplish a similar result for intrastate services. This is not what was intended in the Act Provided the state has not adopted additional definitions and standards to preserve and advance universal service within the state beyond that adopted by the Commission,[14] the Commission has the continued responsibility to establish sufficient and predictable funding necessary to keep rates affordable based on the definition of universal service adopted. This federal responsibility is highlighted in the Joint Board's Recommendation;

> "The federal Universal Service Fund will ensure that telephone rates are within the means of the average subscriber in all areas of the country, thus providing a foundation on which the states can build to develop programs tailored to their individual needs."[15]

Even with interstate support, states will find it necessary to develop universal service funding mechanisms which are complementary to that adopted by the Commission. Many states presently have extremely high implicit subsidies which, in conjunction with existing federal revenue sources, allows local service rates to remain reasonable and affordable. If intrastate end user surcharges necessary to replace implicit subsidies become substantial, it may become necessary to revisit the amount of funding available from the

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[14] Telecommunications Act of 1996, Section 254 (f).

[15] CC Docket No. 96-45 Released November 8, 1996 at Paragraph 818 quoting from CC Docket No. 80-286, Decision and Order, 96 F.C.C. 781, 795 (February 15, 1984).

federal universal service fund in order to maintain affordable local telephone rates as required by the Act. The Act envisions the federal and state jurisdictions working together. It may be necessary for the Commission to devise procedures where high cost rural states can obtain additional federal funding when necessary to maintain affordable rates when eliminating implicit subsidies.

Respectfully Submitted

GVNW Inc./Management

By: Kenneth T Burchett

Kenneth T. Burchett
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December 16, 1996

APPENDIX A

RURAL COMPANY PROXY PHASE IN PROCEDURE
IMPACT OF FROZEN USF PER LOOP
BASED ON 1995 ACTIVITY

The Joint Board Recommendation regarding use of 1995 activity in developing the frozen amount per line will not provide sufficient revenues for those companies which invested substantial amounts in 1996, or those presently in the midst of substantial plant upgrades. The following example compares the revenue per line which can be anticipated in 1998 based on the Joint Board Recommendation with USF revenues which would flow if the existing USF plan remained in place.

This example represents an actual company which aggressively invested in infrastructure in 1996 at the direction of its state commission. As a result, its loop cost has increased substantially in 1996.

	Per Month
Frozen Amount per Line Based on 1995 Activity	\$10.62
Frozen Amount per Line Based on 1996 Activity	\$17.20
Shortfall per line per month	\$ 6.58

Rule changes which will have a substantial impact on future revenues should not be made on a retroactive basis giving the carrier no opportunity to modify its investment plans. Future revenues should be sufficiently predictable that Eligible Carriers can make investments with a reasonable expectation of how those investments will be paid for. By utilizing 1995 actual results, the proposed phase in plan does not accomplish this goal.

The Joint Board expressed concern with the immediate financial impacts rural LECs might experience if required to immediately move to a proxy model:

> "we are concerned that moving small, rural carriers to a proxy model too quickly may result in large changes in the support that they receive."[1]

Unfortunately, the phase in approach which has been advocated by the Joint Board does not adequately resolve the financial concerns facing those small companies that are investing substantial amounts of money in infrastructure development as demanded by the public and the regulators.

[1] CC Docket No. 96-45, released November 8, 1996 at paragraph 283.

APPENDIX B

SUMMARY OF OBSERVATIONS AND ISSUES ON COST PROXY MODELS

Introduction

The Federal-State Joint Board seeks comment on the Recommended Decision, released November 8, 1996. GVNW has begun a working analysis of cost proxy models available to date These include Benchmark II, Hatfield Model 2.2, Version 2 and the Cost Proxy Model Our analysis is moving forward on four fronts, (1) an analysis of the models against defined criteria, (2) the appropriateness of the model's current underlying engineering decisions in a small company environment, (3) the relevance of current inputs applied to a small company environment, and (4) the impact of model results on funding levels for the provisioning of universal service for small companies. Although our evaluation has just begun, this Appendix addresses initial observations that have been made to date. Table 1 highlights several of the issues expressed within.

A. Defined Criteria

Model development must be based on a well defined set of guidelines and underlying principles. Paragraph 277 of the Joint Board Recommendation sets forth criteria by which a reasonable evaluation of any proxy model to produce forward-looking costs shall be conducted. Absent from that list are two primary principles, evaluating the models for competitive neutrality and conformance to TELRIC/TSLRIC methodology. Regarding competitive neutrality, the Joint Board states, "Proxy models, because they are not based on any individual companys' costs, provide a

TABLE 1

HIGHLIGHTS OF MODEL ISSUES

Category	*Issue*
1. General Concerns	--Guidelines for model development require clarification. --Lack of criteria defining "competitively neutral." --Lack of criteria for the use of "least-cost."
2. Engineering Concerns	--Underground and buried cable must be treated separately --Mapping of wire centers, census blocks and demand should be more thoroughly described --Joint ownership of plant is not considered properly. --Possible overdeployment of digital loop carrier by these models --"Desert Start" approach results in unrealistic network engineering decisions. --Outside plant elements are not always considered, i.e. manholes, poles, gauge of wire, bridge tap, loading, etc. --Various network elements are treated differently from one model to the next. --Interoffice facilities network elements are not adequately addressed. --Switching elements are not adequately addressed. --Support networks are not addressed properly (signaling, SS7 and synchronization). --Projecting and provisioning of business lines, residence lines and special access lines requires further review. --Placement of remote switches is not modeled correctly. --Costs for survivability are not considered. --Proper size of study area requires further consideration. --Traffic issues need to be considered. --Alternate technology decisions should be incorporated. --Maintaining network plant and capacity efficiency.
3. Input Considerations	--Inputs are not adequately supported. --Wide degree of variation between models for similar inputs need to be aligned. --Capital investments and technology are considered forward looking, whereas expense inputs are historical.
4. Verification of Model Results	--Application and results of Part 32, 36 and 69 should be reviewed with regard to the proxy models.